Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	

Comments of the Ad Hoc Telecommunications Users Committee

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access voice-grade equivalent (VGE) lines in service was skyrocketing – VGE's increased by 103%, from 71 million to 144 million in that same time frame.[1] The Commission must not "fix" the distortions caused by non-cost-based switched access charges through pollution of special access rate structures. Not only would it be economically irrational to recover switching costs from dedicated special access services, it would be virtually impossible to do so in a manner that did not distort existing pricing relationships between special access facilities of different speeds. Collection of lost interconnection revenues from special access services will almost necessarily hamper the global competitiveness and efficiency of U.S. corporations by interfering with their adoption of new technologies and the use of high bandwidth services through the imposition of uneconomic subsidy elements on those services.

V. "Affordability" Does Not Justify Discrimination Against Multi-Line Business Customers and Special Access Subscribers.

There is no evidence that an increase in the Subscriber Line Charge (SLC) would make telephone service unaffordable for residential and single-line business customers. Accordingly, the Commission cannot use "affordability" as the basis for discriminating against multi-line business customers subscribers by implementing an increase in the Subscriber Line Charge that disproportionately allocates any increase to multi-line users. Economic theory and empirical evidence demonstrate that demand for local telephone service is relatively inelastic, and that relevant increases in the cost of local service would have

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[1] Federal Communications Commission, ARMIS Report 43-08, Operating Data Report: Table III, YE 2000-2004. Available at http://www.fcc.gov/wcb/eafs/ (accessed May 18, 2005).

virtually no effect on residential or business single-line subscribership levels. According to a study by Hausman *et al.,* "[t]he elasticity of local phone service demand with respect to the basic access price [is approximately] -0.005[sic]."[2] This indicates that "a 10 percent price increase leads to only a 0.5 percent decrease in consumption of local service."[3] In the instant case, this means that a 10% rate increase for local service would mean a drop in telephone subscribership from the current level of 93.5% to 93%. Of course the kind of increase in the SLC that would be required here would likely be much less than 10% of the total local service bill. According to the FCC's most recently released *Statistics of Common Carriers*, total switched access revenues for 2003 (interstate and intrastate combined) were $6.9 billion. Assuming that the entire $6.9 billion in charges is eliminated, and assuming that the entire amount is then recovered through increased subscriber-line charges, the result would be something in the neighborhood of not more than a $4.00 per month increase to single line subscriber line charges.[4] As discussed hereinabove, there is no

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[2] Hausman and Shelanski, *Economic Welfare and Telecommunications Regulation: The E-rate Policy for Telecommunications Subsidies,* 16 Yale J on Reg.19, *38 n.85 (1999) (citing Jerry Hausman, *et al., The Effects of the Breakup of AT&T on Telephone Penetration in the United States,* 83 Am Econ Reb. 178 (1993). In the Hausman example, a 10% increase in price and a 0.5% decrease in demand would imply an elasticity of -0.05 and not -0.005 as cited in the text. Were the actual elasticity to be -0.005, a 10% increase in the price of local service would result in a decrease in demand of only a mere -0.05%! We have conservatively assumed that Hausman et al misplaced a decimal point in his measure of elasticity, and that the written example, which falls within a range of reasonableness of other estimates, is the correct measure of local service demand elasticity.

[3] *Id.*

[4] According to the FCC, End User Access Revenue for 2004 was $10 billion. Dividing by the current average SLC of $5.91 yields $1.7 billion which, when divided into the combined End User Access and Switched Access Revenues of $16.96 billion ($10.02 billion + $6.94 billion), yields $9.98 as the average SLC required to recover all additional switched access revenue. Subtracting out the current average SLC leaves the required increase of approximately $4.05. Federal Communication Commission, ARMIS Report 43-02, USOA Report: Table I-1, YE 2004. Available at http://www.fcc.gov/wcb/eafs/ (accessed May 19, 2005).

evidence that that $6.9 billion needs to be recovered in an alternate manner. Nonetheless, even if the Commission were to implement what most would consider a dramatic increase in the residential and single-line SLC Cap, from $6.50 to $10.00, the increase needs to be evaluated against the average total local service bill, not just as an increase in the SLC. The average price for basic local service most recently reported by the Commission is $24.75 (including the current SLC).[5] This "average" price, however, is not reflective of the average *expenditure* on local service since many local service customers also subscribe to various vertical features offered by the LECs. The average monthly expenditure for local service, reported in the FCC's most recent *Trends in Telephone Service* is $36, per month.[6] This means that, all else constant, even in this most extreme example, an increase in the residential and single-line SLC rate of $4.00 would result in an increase in average phone rates of 11.25%. Using Hausman's local service elasticity value cited above, an 11% increase in the price for local service would result in a decrease of a half a percent in the demand for local service. The most recently reported statistics report telephone subscribership at 93.5% of U.S. households.[7] An 11% increase in the price for

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[5] Industry Analysis and Technology Division, Federal Communication Commission, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service* (2004), at Table 1.

[6] *Id., at Table 3.2 ("Trends in Telephone Service").* With the growth in the adoption of local and long distance service bundles, it is possible that many consumers would consider the cost of their bundled service to be the cost of "local service." In cases such as this, the higher apparent price of local service would make a $4.05 increase in the SLC even less influential on subscribership. For example, for customers paying $49.99 for a local and long distance bundle, a $4.05 increase in the SLC would decrease demand by only 0.4%.

[7] Industry Analysis and Technology Division, Federal Communications Commission, *Telephone Subscribership in the United States*, at Table 1 (data as of Nov. 2004).

local service would drop that number to 93%.[8] Other estimates put the value of local service elasticity of demand closer to -0.3 or -0.2.[9] Under those assumptions, the 11% price increase of local service associated with raising the residential SLC by an amount necessary to recover the full $6.9 billion in revenues being generated by interstate and Intrastate switched access charges would result in a corresponding decrease in telephone subscribership levels of 0.34 percent (from 93.5% to 93.2%) in the case of -0.3 demand elasticity, to a decrease of 0.23 percent (from 93.5% to 93.3%) in the case of -0.2 demand elasticity.

The "average" American household spent only 0.69 percent of its annual income on local telephony in 2003, down from 0.85 percent in 1986.[10] Extrapolating that data to the instant proceeding today , the average residential local service bill would need to sustain an increase of $5.93 in per line charges *per month* (beyond the presently effective $6.50 SLC) before it would account for a greater percentage of average annual household expenditures than local service did eighteen years ago.

This unrebutted evidence indicates that residential customers can afford to pay the same amount on a per number basis as business customers, both

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[8] In point of fact, the analysis above likely *overstates* the level of potential subscribership drop-off, because it does not make any adjustment for the fact that the federal and state *Lifeline* plans would shield many low-income customers from any increase in the SLC rate.

[9] Lester Taylor, "Customer Demand Analysis," in Martin Cave and other, eds., *Handbook of Telecommunications Economics, vol. 1, Structure, Regulation and Competition* (Amersterdam: Elsevier, 2002) pp. 126-127. See, in the same volume, Michael H. Riordan, "Universal Residential Telephone Service," at 447.

[10] Calculations were performed by taking the Average Residential Rates for Local Service in Urban Areas as a percentage of Median Income in Current Dollars; results were extrapolated to represent the "average" American household. *Trends in Telephone Service, FCC Industry Analysis Division, Table 3.1, August 2001. Historical Income Tables – Households,* U.S. Census Bureau, Table H-8, http://www.census.gov/hhes/income/histinc/h08.html (accessed May 18, 2005).

initially and prospectively, should there be an increase in the SLC. Therefore, it would be arbitrary and capricious for the Commission to use "affordability" as the basis for requiring business customers to contribute more, on a per line or per number basis, than residential customers.

VI. The Commission Should Create A "Fresh Look" Opportunity.

If the Commission adopts a new intercarrier compensation mechanism that increases Subscriber Line Charges (SLCs) while access charges paid by long distance carriers decline, customers under multi-year contracts would actually incur higher SLCs while (1) their contractual service rates remain unchanged and (2) their long distance service providers' costs drop dramatically, because of the higher SLCs paid by end users. This situation would be inequitable for end users under multi-year contracts with long distance carriers. It would be even worse than the kind of situation from which the Commission previously has protected *carriers*.

In its seminal 1997 Universal Service Reform order[11], the Commission virtually invited carriers to "adjust" pre-existing contracts because carriers would be required to contribute to the USF.[12] The Commission reasoned that,

> By assessing a new contribution requirement, we create an expense or cost of doing business that was not anticipated at the time contracts were signed. Thus, we find that it would serve the public interest to allow telecommunications carriers and providers to make changes to existing contracts

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[11] *Federal-State Joint Board on Universal Service,* CC Dkt. No. 96-45, Report and Order, 12 FCC Rcd 8776 (1997), as corrected by *Federal-State Joint Board on Universal Service,* Errata, CC Dkt. No. 96-45, FCC 97-157 (rel. Jun. 4, 1997), *affirmed in part, reversed in part and remanded in part sub nom. Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999).

[12] *Id.,* at 9209.